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C O R R E C T E D C O P Y (TEXT)

E.O. 12958: N/A
TAGS: [EAIR](#) [ECON](#) [KTIA](#) [CH](#)
SUBJECT: China Southern Airlines Wary of U.S. Competition

REFERENCE: A) Beijing 6841; B) Guangzhou 8841; C) 05
Guangzhou 32752

(U) This message is sensitive but unclassified. Please
handle accordingly.

¶1. (SBU) Summary: In the lead-up to the U.S.-China aviation talks on April 19-20, China Southern Airlines is in a weak financial position and would not want any U.S. airlines competing directly against it. China Southern is resigned to a gradual expansion of its U.S. routes because of continued losses resulting from high fuel prices, a competitive domestic market, and low yields on its existing China-U.S. passenger route. Short-term plans include expanding the frequency of the airline's Guangzhou-Los Angeles flight from five to seven per week by October 2006 and possibly adding a Beijing-New York flight in 2007. End Summary.

¶2. (SBU) On April 11, Econoff visited the Guangzhou headquarters of China Southern Airlines and met with Zhang Lin, vice director general of the Commercial Steering Committee; Li Yong Zhen, general manager of the Planning and Development Department; and Zeng Min, director of industry and alliances of the Network Planning Office.

Upcoming Aviation Talks

¶3. (SBU) China Southern representatives said they will closely follow the U.S.-China aviation talks next week, but are not personally engaged with the Civil Aviation Administration of China (CAAC) on the matter. They deferred to CAAC on the specifics of China's position. Nevertheless, they expressed concern that U.S. airlines, with lower fuel costs and better brand recognition, would be highly competitive in U.S.-China routes.

Guangzhou-L.A. Route is a Money-Loser

¶4. (SBU) China Southern currently operates five flights per week from Guangzhou to Los Angeles, the company's only China-U.S. route. According to Zhang, this route does not earn a profit because the tickets are largely low yield. U.S. and

other international carriers attract first-class and business-class passengers because of their brand recognition and their established routes through Hong Kong and Japan. In addition, the Guangzhou-L.A. flights are on average only 65 percent full, while the average China Southern flight has 70 percent capacity. Nevertheless, China Southern plans to expand the frequency of the Guangzhou-L.A. flights from five to seven per week by October 2006.

15. (SBU) China Southern also has two cargo flights per week, from Shenzhen to Chicago. Li complained that these are also unprofitable because the planes are rarely full on the return trips to China. He added that China Southern plans to convert its cargo airline into an independent entity next year, citing the example of China Eastern (which leads the domestic air cargo market).

16. (SBU) When asked about possible new China-U.S. routes, Zhang said China Southern is considering adding a Beijing-New York flight in 2006. (Note: At this point in the meeting, the representatives talked amongst themselves in Mandarin. Li quipped "We'll just lose more money," to which Zhang replied, "We've got the planes, we have to fly them." End note.)

Business is Bad

17. (SBU) In an earnings report to be released next week, China Southern will report losses for 2005, according to the representatives. (The company reported a net loss of RMB 907 million (USD 110 million) for the first half of 2005.) The representatives blamed the losses largely on high fuel costs. Forty percent of the company's expenditures are on jet fuel, up from 33 percent last year, according to Zeng. Last November, a China Southern board member complained to Congenoffs that Chinese airlines pay twice the price that American airlines pay for jet fuel (Reftel C). The board member said that only 20 percent of U.S. airline expenditures are on fuel.

18. (SBU) When asked about its management structure, Li said China Southern is run like a public enterprise and the board makes key decisions (the company is listed in New York, Hong Kong, and Shanghai). Nevertheless, the Chinese government is the primary stakeholder, and the government continues to have a "great impact on decision-making." For example, in connection with Hu Jintao's visit to the United States this month, Zhang said China Southern will announce the purchase of 30 Boeing aircraft.

On Mergers

19. (SBU) The representatives insisted that the company has no plans to merge with other Chinese airlines, and said any information to the contrary is rumor. Zhang said CAAC would never approve a merger between China Southern and Air China because of monopoly concerns. He said that in 1998, when China Southern and Air China were talking to each other about a possible merger, CAAC quickly put a stop to discussions. He said the same reasoning applies today. Following up, Zhang expressed concern about the possibility of several major U.S. airlines merging into a "supercarrier."

Comment

110. (SBU) The representatives were noticeably downbeat about the company's financial health. At one point, Li remarked "We work for the oil companies and banks." Though they are intent on gradually becoming a strong global competitor, their first priority seems to be figuring out how to make a profit. This is particularly true for the existing Guangzhou-L.A. flight.

110. (SBU) U.S. airlines are making slow inroads into

Guangzhou. China Southern has a code-sharing agreement with Delta, and Zeng said they are in discussions with Continental about similar cooperation. China Southern has a frequent-flier program with Northwest Airlines. Since it thus far has no presence in Guangzhou, United is probably the most eager of the U.S. airlines to expand into the Guangzhou market, but it may also be that United is one U.S. airline that China Southern is eager not to let in if at all possible.

DONG